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In the Supreme Court of the United States

OCTOBER TERM, 1976

THE CITIZENS AND SOUTHERN NATIONAL BANK, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

No. 76-908. The order and judgment of the United States District Court for the Southern District of Georgia (Pet. App. 21a-30a) are not officially reported. The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 538 F. 2d 1101.

No. 76-909. The opinion of the United States District Court for the Middle District of Georgia (Pet. App. 16a-23a) is not officially reported. The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 538 F. 2d 1101.

JURISDICTION

No. 76-908. The judgment of the court of appeals (Pet. App. 17a-18a) was entered on September 15, 1976, and a petition for rehearing with suggestion for rehearing

en banc was denied on November 16, 1976 (Pet. App. 19a). The petition for a writ of certiorari was filed on December 30, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

No. 76-909. The judgment of the court of appeals (Pet. App. 24a-25a) was entered on September 15, 1976, and a petition for rehearing with suggestion for rehearing *en banc* was denied on November 16, 1976 (Pet. App. 25a-26a). The petition for a writ of certiorari was filed on December 30, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether petitioner was required to honor federal tax levies on bank accounts of two of its depositors, when petitioner had not attempted to set off the balances in the accounts against debts owed to it by the depositors until after the service of the tax levies.

2. Whether the court of appeals erred in not explicitly addressing petitioner's claim that the tax levies denied it due process.

STATUTES INVOLVED

Sections 6321, 6323(a) and (h), 6331(a), and 6332(a) and (c) of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. App. 31a-33a (No. 76-908) and Pet. App. 26a-30a (No. 76-909).

STATEMENT

In these two cases, petitioner challenges federal income tax levies on the accounts of two of its depositors. Because the issues are similar in each case, the court of appeals disposed of the cases in one opinion.

No. 76-908. On May 2, 1973, the Commissioner of Internal Revenue made a jeopardy assessment of $741,093.49 for unpaid wagering excise taxes against Robert W. Best, one of petitioner's depositors. On May 3, 1973, after Best had failed to pay the assessment upon demand, a notice of tax levy was served on petitioner, directing it to pay to the Internal Revenue Service the balance in Best's checking account,[1] which, at the time of the levy, was approximately $57,365.58 (Pet. App. 3a-4a, 22a).

At the time of the service of the notice of levy, petitioner held promissory notes from Best which exceeded the balance in his account. These notes contained the following provisions (Pet. App. 4a-5a):

> To secure the payment of this Note and all other indebtedness or liabilities of the undersigned to Holder, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, or due or to become due (hereafter with this Note, collectively called "Liabilities"), undersigned transfers and conveys to Holder any and all balances, credits, deposits, accounts, items and monies of the undersigned now or hereafter with the Holder, and the undersigned agrees that the Holder shall have a lien upon, security title to and a security interest in all property of the undersigned of every kind and description now or hereafter in the possession or control of the Holder for any reason * * *.

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[1]Best actually had several accounts with petitioner, but the terms of their contractual relationship were substantially the same on each of these accounts (Pet. App. 4a n. 1). For purposes of convenience, we refer to these accounts as a single account.

Each note also provided that in the event any payment was not made, or petitioner felt "insecure," petitioner could declare the note due and payable and offset the amount due against any balance in taxpayer's bank account (Pet. 4-5; Pet. App. 4a-6a, 22a-23a).[2] Prior to the tax levy, petitioner honored checks drawn on Best's account (R. 135, 195).[3]

On May 4, 1973, the day after the notice of levy had been served, petitioner wrote Best that as of that date it had applied his account against the balance due on his notes owed to petitioner. However, petitioner did not actually charge Best's account and credit his notes until May 8, 1973 (Pet. 5; Pet. App. 4a, 23a). Petitioner thereafter notified the Internal Revenue Service that it had applied the balance in Best's account to the amounts he owed it (Pet. 5; Pet. App. 23a).

As a result of petitioner's refusal to honor the levy, the government subsequently commenced this suit in the United States District Court for the Southern District of Georgia to enforce the levy upon Best's account (Pet. 5; Pet. App. 3a, 21a, 23a). The district court held that at the time of the levy petitioner was not in possession of any of Best's property or rights to his property (Pet. 5-6; Pet. App. 6a, 28a). In the district court's view, the terms of the promissory notes operated to assign all of Best's rights to the balance of his account to petitioner (Pet. App. 26a-28a). It therefore entered judgment in favor of petitioner (Pet. App. 30a).

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[2]The personal checking account signature form signed by Best when he opened the account also purported to assign to petitioner all balances in his account to secure any indebtedness, whenever incurred, which might be due or become due from Best to petitioner, and to give petitioner the right to offset any such indebtedness against the account (Pet. App. 5a-6a, 28a).

[3]"R." refers to the record appendix filed in the court of appeals.

The court of appeals unanimously reversed and remanded the case to the district court for entry of judgment for the government. It held that the terms of the promissory notes did not transfer Best's property rights in the account to petitioner (Pet. App. 9a-12a). The court further ruled that as long as a bank depositor who is indebted to a bank is permitted to continue to withdraw funds from his account, the bank cannot be deemed to have made a setoff of the account against the debt until it takes some positive act to exercise its right of setoff. Since petitioner had not set off the account prior to the service of the levy, Best retained his property interest in the account. The account was therefore subject to the tax levy (Pet. App. 12a-15a).

No. 76-909. On June 10, 1969, the Commissioner of Internal Revenue made an assessment of $10,512.04 against B & G Salvage Service, Inc., for unpaid withholding and social security taxes for the third and fourth quarters of 1968 and the first quarter of 1969 (Pet. 4; Pet. App. 6a, 18a; R. 24-55). On June 13, 1969, the Internal Revenue Service filed a tax lien in the proper recorder's office after B & G had failed to pay the assessment. Ten days later, on June 23, 1969, a notice of levy was served on petitioner directing it to surrender to the Internal Revenue Service the balance in B & G's bank account which, at the time the levy was served, was $1,977.38 (Pet. 4; Pet. App. 6a, 18a). After receiving the notice of levy, petitioner applied the amount in B & G's account against the balance due on a note B & G owed to petitioner (Pet. 4; Pet. App. 6a, 18a).

At the time of the notice of levy, B & G had a loan outstanding from petitioner which exceeded the balance in its checking account (Pet. 4; Pet. App. 19a). In obtaining

the loan, B & G had executed a collateral installment note which contained the following language (Pet. App. 6a, 17a):

> * * * the Holder may, at any time, without demand or notice of any kind, appropriate and apply toward the payment of * * * the Liabilities, and in such order of application, as the Holder may from time to time elect, any balances, credits, deposits, accounts, items or monies of the undersigned with the Holder.

The deposit agreement, which B & G executed upon opening its checking account with petitioner, provided (Pet. 4; Pet. App. 17a-18a):

> To secure any and all indebtedness and liability of Depositor to Bank, however and whenever incurred or evidenced, whether direct or indirect, absolute or contingent, due, or to become due, Depositor hereby transfers and conveys to Bank all balances, credits, deposits, monies and items now or hereafter in this account and Bank is authorized at any time to charge such indebtedness or liability against this account, whether or not the same is then due * * *.

Although B & G had not paid any of the installments on the loan on time, petitioner had not, at the time of the levy, made any offset under the applicable provision of the note or the deposit agreement (Pet. 4; R. 23-24). Prior to the tax levy, petitioner was honoring checks on B & G's account (R. 52).

Following petitioner's refusal to honor its tax levy, the government instituted this suit in the United States District Court for the Middle District of Georgia to enforce the levy on B & G's account (Pet. 5; Pet. App. 2a, 19a). The district court held that "the * * * bank deposit was neither property nor right to property,

nor even a claim upon which the Government could levy" (Pet. App. 22a), and that petitioner "had a contractual lien and security interest in the deposit" which defeated the government's tax lien (Pet. App. 22a). In accordance with its holding in No. 76-908 (see p. 5, *supra*), the court of appeals unanimously reversed and remanded the case to the district court for entry of judgment for the government (App. 8a-9a, 11a-12a).

ARGUMENT

1. a. Section 6331 of the Internal Revenue Code of 1954 provides that if any person liable to pay any tax neglects or refuses to discharge his obligation, the Commissioner may then levy upon all property and rights to property belonging to the taxpayer. Section 6332 of the Code requires that once the Internal Revenue Service levies upon the delinquent taxpayer's property "[the] person in possession of * * * property or rights to property subject to levy" must surrender such property or rights to property to the Internal Revenue Service, and if he fails to do so he shall be liable to the United States in a sum equal to the value of property or rights not so surrendered.

State law controls the nature and extent of a person's interest in property. However, once it is determined under state law that a taxpayer has rights in certain property, the priorities of the competing interests to the property are resolved under federal law. See, *e.g.*, *Aquilino* v. *United States*, 363 U.S. 509, 513-514; *United States* v. *Bess*, 357 U.S. 51, 55.

The court of appeals correctly applied the foregoing principles in these cases. It determined that under Georgia law a depositor in a bank becomes a creditor of the bank and that the balance in his account is a chose in action against the bank. *Georgia Bank & Trust Co.* v.

Hadarits, 221 Ga. 125, 143 S.E.2d 627. *Macon National Bank* v. *Smith*, 170 Ga. 332, 337, 153 S.E. 4, 6-7; *Ricks* v. *Broyles*, 78 Ga. 610, 3 S.E. 772; *McGregor* v. *Battle*, 128 Ga. 577, 58 S.E. 28. Moreover, under federal law, a chose in action is property that is subject to a tax levy. *United States* v. *Hubbell*, 323 F. 2d 197, 200 (C.A. 5). See also *United States* v. *Metropolitan Life Ins. Co.*, 130 F. 2d 149 (C.A. 2). Since petitioner freely permitted the depositors to withdraw funds from their accounts prior to the service of the notice of levy, it is plain that the depositors had property rights in their accounts to which the levy could attach. See *United States* v. *Sterling National Bank & T. Co. of N.Y.*, 360 F. Supp. 917 (S.D. N.Y.), affirmed in part, 494 F. 2d 919 (C.A. 2); *Bank of America* v. *United States*, 345 F. 2d 624 (C.A. 9), certiorari denied, 382 U.S. 927; *Bank of Nevada* v. *United States*, 251 F. 2d 820 (C.A. 9), certiorari denied, 356 U.S. 938. The court of appeals therefore properly concluded that petitioner's attempted exercise of its right of setoff *after* the notice of levy was served was to no avail.

b. Petitioner contends (Pet. 12 (No. 76-908); Pet. 7 (No. 76-909)) that the decision below misconstrued the relevant Georgia case law. But as the court of appeals correctly noted (Pet. App. 11a-12a (No. 76-908)), the Georgia decisions do not support the proposition that a purported assignment of a balance in a depositor's account as security for that depositor's note held by the bank completely divests the depositor of all property rights in his account. Rather, such purported assignments simply operate to give the bank a lien or preference with respect to the balance in the account, and the depositor

retains property rights that are subject to a federal tax levy.[4]

For example, in *Macon National Bank* v. *Smith*, *supra*, the Georgia Supreme Court considered a situation involving the competing claims of a bank, which held a note of its depositor containing provisions similar to those in the notes in these cases, and a garnishing creditor of the depositor. There, the court upheld the bank's contention that the note evidencing the debt created a lien or right against the deposit in favor of the bank. In so holding, the court stated that upon the deposit of money with the bank, a chose in action was created which the note transferred, as collateral security, to the bank. Its ruling in favor of the bank was based upon its view that (170 Ga. at 338-339): "The interest of the bank as transferee of the deposit account vested at the date of the note * * * prior to summons of garnishment * * *, and therefore was entitled to *preference*, as against Smith, the garnishing creditor" (emphasis supplied). Thus, *Macon National Bank* does not hold that the interest in the depositor's account which was transferred to the bank by the note divested the depositor of all his rights in the account, but only that the bank had a "preference" or prior lien upon the depositor's account.[5]

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[4]Nor does Section 85-1803 of the Code of Georgia Annotated (1970), which petitioner contends (Pet. 8 (No. 76-908); Pet. 7 (No. 76-909)) that the court of appeals disregarded, require a different result. That statute only provides that a chose in action *may* be assigned so as to vest title in the assignee. It does not answer the question whether the purported assignments here were effective.

[5]Accord: *Georgia Bank & Trust Co.* v. *Hadarits*, *supra*. There, the Georgia Court of Appeals ruled that a bank that held a note of its depositor and an assignment of its depositor's accounts as collateral security for the note could defeat the claims of a drawee of one of its depositor's checks. As the court stated (221 Ga. at 126), the bank

But the existence of a prior lien is not a defense to a suit to enforce a levy. *United States* v. *Sterling National Bank & T. Co. of N.Y., supra; Bank of Nevada* v. *United States, supra; Commonwealth Bank* v. *United States*, 115 F. 2d 327 (C.A. 6); *United States* v. *Trans-World Bank*, 382 F. Supp. 1100, 1105 (C.D. Cal.). Thus, since Georgia law did not completely divest the depositors of property rights in their accounts, the court of appeals correctly held that the Georgia decisions did not justify petitioner's failure to honor the levies. Indeed, as the court of appeals observed (Pet. App. 12a (No. 76-908)), "[i]t would be anomalous to hold one entitled to a preference with respect to, or a lien upon, property of which he was the sole and absolute owner."

c. Petitioner further argues (Pet. 2-3, 14 (No. 76-908); Pet. 8-9 (No. 76-909)) that it had a security interest in the bank account which was superior to the government's tax lien. But Section 6332(a) of the Code provides that once the Internal Revenue Service levies upon property, the person in possession of property or rights to property subject to levy must surrender it to the Internal Revenue Service unless the property is "subject to an attachment or execution under any judicial process." Since a prior lien does not defeat a levy under the statute, such a claim, as we have pointed out above,

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was "invested with a lien" upon all deposits of the maker of the note. Although the Georgia Supreme Court reversed the Georgia Court of Appeals with respect to whether the lien was unqualified, its decision did not affect the Georgia Court of Appeals' statement (111 Ga. App. 195, 200, 141 S.E.2d 172, 176; emphasis added) that *Macon National Bank* "held that, as between a bank and a garnishing creditor of the maker of a note payable to the bank, the bank had *priority* in the account of the maker."

cannot be asserted as a defense to a suit to enforce a tax levy.[6]

In any event, petitioner did not have a "security interest" in its depositors' accounts as that term is defined by Section 6323(h)(1) of the Code. Under that statute, a security interest is defined as any interest in property acquired by contract, providing the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation. By so providing, Congress intended that the federal definition of a security interest would conform to the terminology of the Uniform Commercial Code. See S. Rep. No. 1708, 89th Cong., 2d Sess. 13 (1966); H.R. Rep. No. 1884, 89th Cong., 2d Sess. 11-12 (1966). But under the Uniform Commercial Code as adopted in Georgia, a "security interest" does not include a setoff. See Uniform Commercial Code of Ga. Ann., §109A-1—201(37) (1973). Moreover, Article 9, which deals in detail with secured transactions, does not apply to any right of setoff. See Uniform Commercial Code of Ga. Ann., §109A-9—104(g) (1973). Thus, petitioner's right of setoff is not a security interest under Section 6323(h)(1).[7]

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[6]As the court of appeals correctly observed (Pet. App. 12a (No. 76-908)), if petitioner wanted to contest priority, it could have first honored the levy and then instituted an action for wrongful levy against the government under 26 U.S.C. 7426.

[7]Indeed, at the time of the enactment of Section 6323(h) as part of the Federal Tax Lien Act of 1966, Congress rejected a proposal to protect the setoff rights of banks against tax liens. See Hearings on H.R. 11256 and H.R. 11290 (Priority of Federal Tax Liens and Levies) before the House Committee on Ways and Means, 89th Cong., 2d Sess. 94-95, 158, 190-191, 217 (1966).

2. Finally, in No. 76-909, petitioner contends (Pet. 9-12) that the court of appeals' remand for entry of judgment for the government denied it the right to be heard on its claim that the levies denied it due process.[8] But contrary to petitioner's contention, this Court has consistently "allowed [the] summary seizure of property to collect the internal revenue of the United States" (*Fuentes* v. *Shevin*, 407 U.S. 67, 91-92; *Phillips* v. *Commissioner*, 283 U.S. 589, 596; *G. M. Leasing Corp.* v. *United States*, No. 75-235, decided January 12, 1977, slip op. 13, n. 18). As long as there is an adequate opportunity for a post-seizure determination of the taxpayer's rights, there is no due process violation. See *Commissioner* v. *Shapiro*, 424 U.S. 614, 630-633. Since petitioner's due process claim is without merit, it did not warrant formal disposition by the courts below.

CONCLUSION

The petitions for writs of certiorari should be denied.

Respectfully submitted.

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[8]The district court had no occasion to reach petitioner's constitutional claim because it decided the case in petitioner's favor on the basis of Georgia law.